No. 609

Office - Supreme Court, U. S.
FILED
DEC 31 1942
CHARLES ELMORE CROPLEY

Supreme Court of the United States.

OCTOBER TERM, 1942.

BOSTON ELEVATED RAILWAY COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT.

The petitioner, Boston Elevated Railway Company, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the First Circuit entered in the above-entitled cause on November 4, 1942.

Opinions Below.

The opinion of the Board of Tax Appeals (R. 98-118) is reported at 45 B.T.A. 906. The opinion of the Circuit Court of Appeals (R. 127-135) is not yet reported.

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on November 4, 1942 (R. 135). The jurisdiction of this court is invoked under Section 240(a) of the Judicial Code, as amended by Act of February 13, 1925.

Question Presented.

Whether certain payments or advances made to petitioner by the Commonwealth of Massachusetts under legislative Act (Mass. Sp. Stat. 1918, c. 159, as amended), which were required under certain conditions specified in said Act to be repaid by petitioner to the Commonwealth, should be included in petitioner's gross income in the year received for the purpose of taxation.

Statutes Involved.

The material portions of Mass. Sp. Stat. 1918, c. 159, and amendatory Acts, are printed in the Appendix, *infra*, pp. 10-28.

Statement.

The Boston Elevated Railway Company is a corporation engaged in the business of transportation of passengers by means of elevated, subway, surface railway and bus lines in the City of Boston and suburban cities and towns. Since July, 1918, the company, and all of the properties owned, leased and operated by it, have been managed and operated under chapter 159 of the Special Acts of the General Court of Massachusetts for the year 1918 (hereinafter referred to as the Public Control Act), as amended, by a Board of Trustees appointed by the Governor of the Commonwealth (R. 63, 101).

The Public Control Act provided, *inter alia*, that the trustees should from time to time fix rates of fare sufficient to cover the cost of service, as defined in said Act (sec. 6). A reserve fund was established under the requirements of said Act which provided that, whenever the income of the company was insufficient to meet the cost of the service, the

reserve fund should be used to make up such deficiency, and that whenever, on the other hand, such income was more than sufficient to meet the cost of the service, the excess should be transferred to and become a part of the reserve fund (sec. 9).

The Act also provides that if, as of the last day of June in any year (as to years subsequent to 1934 this date has been changed by statute from June to March), the amount remaining in the reserve fund was insufficient to meet the deficiency in income, the trustees should notify the Treasurer of the Commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and that the Commonwealth should thereupon pay over to the company the amount so ascertained (sec. 11). The Act further provided that the Commonwealth should thereupon make a proportionate assessment of the amount of any such deficit payment by an addition to the next state tax upon the cities and towns served by the company (sec. 14).

Said Act further provided that if, as of the last day of June in any year (March, as to years subsequent to 1934), the reserve fund should exceed the amount originally established, the trustees should apply the excess, so far as necessary, to reimburse the Commonwealth for any amounts which it had theretofore paid to the company, and that the Commonwealth should thereupon distribute the amount so received among the cities and towns in which the company operated in proportion to the amounts for which they had been respectively assessed (sec. 11).

At the expiration of the period of public control, if the reserve fund should be less than the amount originally established, the Commonwealth is required to pay over to the company an amount sufficient to restore it to its original amount, and, on the other hand, if the reserve fund then should exceed the amount originally established, such excess

is required to be paid by the company to the Commonwealth (sec. 13). The period of public control was extended by Mass. St. 1931, c. 333 (Appendix, p. 21), to July 1, 1959, and thereafter unless terminated in the manner therein provided.

As of the last day of June in the years 1933 and 1934 and as of the last day of March in the years 1935 to 1937, inclusive, there was a deficiency, as referred to in said Act, in the income of the company and, there being no amount remaining in the reserve fund on any of said dates, the Commonwealth, upon notification by the Trustees, paid over to the company in each of said years the amount of the respective deficiencies, in accordance with the terms of said Public Control Act (R. 107-109). The controversy relates to the taxability of these payments.

The Board of Tax Appeals held that the payments made to petitioner by the Commonwealth in each of said years should be taken into petitioner's gross income for the purpose of taxation, and entered its decisions determining deficiencies accordingly (R. 118-119). Petitioner filed a petition for review with the Circuit Court of Appeals for the First Circuit and that court affirmed the decisions of the Board of Tax Appeals (R. 135).

Reasons for Granting the Writ.

1. The decision of the court below decides an important question of federal law which has not been, but which your petitioner submits should be, settled by this court. The question of whether payments or advances made to petitioner by the Commonwealth under the terms of the Public Control Act should be included in petitioner's gross income for the purpose of taxation in the year received is of great import to the Commonwealth of Massachusetts and to the cities and towns upon which rest the ultimate burden of

meeting annually any deficiencies, including taxes, resulting from petitioner's operations. By the term of St. 1931, c. 333, sec. 1 (Appendix, p. 21), public management and operation of petitioner is to continue at least until 1959. In each unprofitable year during this period when a deficit is experienced, the same question will recur, and in each profitable year when the operating income of petitioner exceeds the cost of the service and a repayment back to the Commonwealth is made by petitioner under the requirement of section 11 of the Public Control Act, the correlative question of the deductibility for tax purposes of such repayments will be involved. The question of whether in a prosperous year the earnings of petitioner in excess of the cost of the service are subject to federal income taxation, or of whether repayments in subsequent years made by petitioner to the Commonwealth are deductible for tax purposes in the year when such repayments are made, should depend upon the primary question of whether the payments or advances made by the Commonwealth under section 11 of the Public Control Act are taxable to petitioner in the year received.

The correctness of the decision of this primary question by the Circuit Court of Appeals, affecting, as it does, in each year during the remaining period of public control, the rights and liabilities not only of petitioner, but of all of the taxpayers in the cities and towns served by the railway system, presents an important question of federal law that should be settled by this court.

2. An additional reason for the granting of the writ is that the decision of the court below is in conflict with the decisions of other Circuit Courts of Appeals.

In the cases of *McKnight, Adm.*, v. *Commissioner*, 127 Fed. (2d) 572, and *Clinton Hotel Realty Corporation* v.

Commissioner, 128 Fed. (2d) 968, the Circuit Court of Appeals for the Fifth Circuit held that advances subject to repayment did not constitute taxable income, because of the offsetting obligation to repay.

In *Island Creek Petroleum Co.* v. *Commissioner,* 57 Fed. (2d) 992 (certiorari denied, 287 U.S. 646), the Circuit Court of Appeals for the Fourth Circuit held that the fact that the obligation to repay was contingent did not affect the taxable character of the transaction, saying:

> "And it makes no difference in the result if we construe the agreement as requiring repayment by the Texas corporations only in the event that their operations should prove successful. A loan is no less a loan because its repayment is made contingent . . ."

Section 11 of the Public Control Act provides in part as follows:

> "Section 11 [as amended by Sp. Acts of 1919, c. 244]. If as of the last day of June* in the year nineteen hundred and nineteen, or the last day of any June* thereafter, the amount remaining in the reserve fund shall be insufficient to meet the deficiency mentioned in section nine, it shall be the duty of the trustees to notify the treasurer and receiver general of the commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and the commonwealth shall thereupon pay over to the company the amount so ascertained.
>
> . . . . . .
>
> "If as of the last day of any June* thereafter during the period of public operation the reserve fund

*As to years subsequent to 1934, this date has been changed from "June" to "March." St. 1935, c. 99.

> shall exceed the amount originally established, the trustees shall apply the excess so far as necessary to reimbursing the commonwealth for any amounts which it may have paid to the company under the provisions hereof."

The same question presented by the instant cases was before the Board of Tax Appeals in cases involving earlier years, and the Board there decided, contrary to its decision in the instant cases, that the payments from the Commonwealth to petitioner were not income taxable to petitioner. *Boston Elevated Railway Co.* v. *Commissioner*, 37 B.T.A. 494. In its former decision the Board said:

> "It is thus apparent that by the very language of the acts which form the agreement between the petitioner and the commonwealth both parties thereto understood and agreed that the payments back and forth through the reserve fund were advances and repayments as the profitable or unprofitable operations of the railway dictated. The sum of $1,775,338.80, therefore, was not income taxable to the petitioner in 1932."

It is submitted that this is a correct statement of the situation.

The court below, in concluding that the payments by the Commonwealth were not in the nature of loans or advances subject to repayment under the conditions specified in section 11 of the Public Control Act, lays considerable stress upon the provisions of section 13 of that Act, which require, upon the expiration of the period of public control, that the Commonwealth shall make up any deficiency in the reserve fund and that any sum then in the reserve fund in excess of the amount originally established

shall be paid over to the Commonwealth. But this in no way relieves petitioner of the obligation imposed by section 11 to repay annually out of excess earnings all amounts theretofore advanced by the Commonwealth. The requirement that the company shall pay over to the Commonwealth at the end of the period of public control the excess sum, if any, then in the reserve fund over the amount originally established is, as the court below correctly observes, applicable even if petitioner had repaid to the Commonwealth all amounts previously advanced, or, indeed, even if the Commonwealth had made no previous advances. This, however, does not derogate from the definite obligation imposed by section 11 of the Act upon petitioner to repay annually out of excess earnings all amounts theretofore advanced by the Commonwealth. It merely imposes an additional obligation upon petitioner at the end of the period of public control.

The court below considered that the instant cases were controlled in principle by the decision of this court in *Texas & Pacific Railway Co.* v. *United States,* 286 U.S. 285. In this respect petitioner submits the court was in error. That case dealt with a payment received by the company there involved under the Transportation Act of 1920, guaranteeing a minimum operating income for a period of six months after the relinquishment of federal control, upon condition of the carrier's agreement that, if its operating revenue for that period should exceed the specified amount, the excess should be paid into the Treasury. This agreement covered but a single six months' period. If a carrier's income for such period fell below the specified minimum, as it did with the railroad involved in the above case, the difference was paid by the government, without any obligation—contingent or otherwise—upon the carrier to repay anything. The payments made to the carrier in that case represented a final settlement determined after the

expiration of the guaranteed period, and was received by it free and clear. What it received it had the unconditional right to keep.

That case would be analogous to a payment made by the Commonwealth in final settlement at the end of the period of public control, when there would be no obligation upon the company subsequently to repay anything. But the payments involved in the instant cases were *interim* payments which petitioner was obligated to repay in subsequent years under the conditions specified in section 11 of the Public Control Act. The only question here presented is as to the effect of this offsetting obligation. It is obvious that the *Texas & Pacific Railway* case, *supra,* where this question was in no way involved is not in point.

Conclusion.

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

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APPENDIX.

Chapter 159 of the Special Acts of the General Court of the Commonwealth of Massachusetts for 1918.

AN ACT TO PROVIDE FOR THE PUBLIC OPERATION OF THE BOSTON ELEVATED RAILWAY COMPANY.

SECTION 1. The board of Trustees of the Boston Elevated Railway Company is hereby created, to consist of five persons to be appointed by the governor, with the advice and consent of the council. The persons so appointed shall be sworn before entering upon the performance of their duties; shall own no stock or other securities of the Boston Elevated Railway Company or of any company owned, leased or operated by it; shall serve for the term of ten years from the date when they assume the management of the company as hereinafter provided and until their successors are duly appointed and qualified, and each shall receive from the company as compensation for his services five thousand dollars annually. In case of any vacancy in said board by reason of death, resignation or otherwise, the governor, by and with the consent of the council, shall fill the vacancy. The board shall designate one of the trustees so appointed to serve as chairman. Any member of the board may be removed for cause by the governor, with the advice and consent of the council.

Said trustees shall not be considered public officers within the meaning of section twenty-five of chapter five hundred and fourteen of the acts of nineteen hundred and nine, but shall be subject in all other respects to the provisions of said section to the same extent as are the directors of the Boston Elevated Railway Company, but said section shall not apply to recommendations by the governor to said trustees. The provisions of section one of chapter seven of the Revised Laws shall not apply to the said board.

If the public management and operation of the railway system of the Boston Elevated Railway Company shall continue beyond the original period of ten years the governor shall, with the advice and consent of the council, at the expiration of each ten-year period during the continuance of public management and operation, appoint five successor trustees to

serve for a period of ten years and until their successors are appointed and qualified, but not exceeding the period of public management and operation. Said trustees shall assume the management and operation of the company's property on the first day of the month next following their appointment and qualification.

SECTION 2. Said board of trustees, hereinafter called the trustees, shall manage and operate the Boston Elevated Railway Company hereinafter called the company, and the properties owned, leased or operated by it, for a period of ten years, commencing on the first day of the month next after their appointment and qualification, and subject to the provisions of this act, shall take and have possession of said properties in behalf of the commonwealth during the period of public operation, and, for the purposes of this act, shall, except as is otherwise provided in this act have and may exercise all the rights and powers of said company and its directors, and, upon behalf of said company, shall receive and disburse its income and funds. They shall have the right to appoint and remove in their discretion the president, treasurer and clerk of the corporation, and all officers of the company other than the board of directors. They shall have the right to regulate and fix fares, including the issue, granting and withdrawal of transfers, and the imposition of charges therefor, and shall determine the character and extent of the service and facilities to be furnished, and in these respects their authority shall be exclusive and shall not be subject to the approval, control or direction of any other state board or commission.

In the management and operation of the said company and of the properties owned, leased or operated by it, as authorized by this act, the trustees and their agents, servants and employees shall be deemed to be acting as agents of the company and not of the commonwealth, and the company shall be liable for their acts and negligence in such management and operation to the same extent as if they were in the immediate employ of the company, but said trustees shall not be personally liable. A majority of the board shall constitute a quorum for the transaction of business, and the action of a majority of those present at any meeting shall be deemed the action of the trustees.

Nothing herein contained shall be held to affect the right of the commonwealth or any subdivision thereof to tax the company or its stockholders in the same manner and to the same extent as if the company had continued to manage and operate its own property.

SECTION 3. The trustees shall have authority to make contracts in the name and on behalf of, and to issue stocks, bonds and other evidences of indebtedness of, the company. No contracts for the operation or lease of any subways, elevated or surface lines in addition to those now owned, leased or operated by the company, or any extensions thereof beyond their present limits, shall be entered into which shall involve the payment of any rental or other compensation by the company beyond the period of public operation without the consent of the directors of the company, but surface lines may be constructed or purchased beyond the limits of existing surface lines after consent of the directors has been refused, if the trustees shall determine, after a public hearing, that public necessity and convenience require such construction or purchase: *provided, however,* that if the commonwealth shall elect under the provisions of section twelve to discontinue the public management and operation of the company's property, no such surface lines shall thereafter be constructed or purchased without such consent.

All the authority heretofore granted to the company to accept the provisions of section five of Part I of chapter seven hundred and forty-one of the acts of nineteen hundred and eleven, as amended by chapter two hundred and ninety-seven of the Special Acts of nineteen hundred and fifteen, is hereby conferred upon the trustees during the term of public operation, and the trustees shall have all powers which the company now has to enter into a contract under the provisions of chapter three hundred and forty-two of the Special Acts of nineteen hundred and sixteen; and upon the acceptance of such contract, any and all powers and obligations granted to and imposed upon any and all boards and municipalities by said act, had the company accepted the contract, shall thereby be extended, revived and restored, so that such contract shall have the same force and effect as if the company had accepted it. The trustees shall cause to be paid all amounts which may

from time to time become due from the company, and shall declare dividends at the appointed times upon the preferred and common stock of the company, and provide for the payment of the same.

SECTION 4. The stockholders of the company shall, as heretofore, elect a board of directors which shall, however, during the period of public operation, have no control over the management and operation of the street railway system, but its duties shall be confined to maintaining the corporate organization, protecting the interests of the corporation so far as necessary, and taking such action from time to time as may be deemed expedient in cases, if any, where the trustees cannot act in its place. The by-laws of the company shall be modified, as far as may be necessary, to conform to the provisions of this act.

By its acceptance of this act, the company and the stockholders and directors thereof shall be deemed to have assented to and authorized all issues of stock, bonds and other evidences of indebtedness which the trustees may find necessary or advisable during the period of public operation, or which may be required during the period of public operation to carry out any existing or future obligations of the company; but, notwithstanding such assent and authorization, the stockholders and directors shall from time to time take such action with respect thereto as may be requested by the trustees.

Such sum as may be deemed reasonable shall be allowed to the board of directors each year by the trustees to provide for the maintenance of the corporate organization of the company and the performance of such duties as may be necessary by the company and the directors.

SECTION 5. The Boston Elevated Railway Company shall, prior to or at the time of its acceptance of this act, provide for raising three million dollars in cash by the issue of preferred stock at not less than the par value which shall be one hundred dollars per share. Such preferred stock shall be subject to the preferred stock authorized to be issued upon the acquisition of the West End Street Railway Company by chapter seven hundred and forty of the acts of nineteen hundred and eleven. Such preferred stock shall be issued only with the approval of

the holders of a majority of the entire capital stock of the company outstanding given at a meeting called for the purpose, shall be entitled to such cumulative, preferential dividends, not exceeding seven per cent per annum, and to such preferences in liquidation, as the stockholders may determine, and shall be subject to retirement at the request of the trustees or after the period of public operation by the company at one hundred and five dollars per share and accrued dividends. The issue of said stock shall not require the approval of the public service commission, but if the remaining sections of this act fail to take effect as provided in section eighteen, such issue and the subscription thereto shall be null and void.

One million dollars shall be set aside as a reserve fund to be used only for the purposes hereinafter specified, and the remaining two million dollars shall be subject to the disposition of the trustees to pay for the cost of additions and improvements to the company's property.

Payment of not less than thirty per cent of the subscription, to such new preferred stock shall be made upon subscription, and the balance shall be callable in instalments from time to time by the trustees as in their judgment the money may be needed. Interest shall be payable upon the amounts paid in upon the said subscriptions at the same rate fixed for dividends upon the preferred stock. Such new preferred stock shall be offered for subscription pro rata to the stockholders of the company at not less than par, and the provisions of sections one hundred and eleven and one hundred and twelve of Part III of chapter four hundred and sixty-three of the acts of nineteen hundred and six, and of chapter six hundred and thirty-six of the acts of nineteen hundred and eight shall not apply to the issue or disposition of such stock.

SECTION 6. The trustees shall from time to time, in the manner hereinafter provided, fix such rates of fare as will reasonably insure sufficient income to meet the cost of the service, which shall include operating expenses, taxes, rentals, interest on all indebtedness, such allowance as they may deem necessary or advisable, for depreciation of property and for obsolescence and losses in respect to property sold, destroyed, or abandoned, all other expenditures and charges which under the laws of the commonwealth now or hereafter in effect may

be properly chargeable against income or surplus, fixed dividends on all preferred stock of the company from time to time outstanding, and dividends on the common stock of the company from time to time outstanding at the rate of five per cent per annum on the par value thereof during the first two years, five and one half per cent per annum on the par value thereof during the next two years and six per cent per annum on the par value thereof during the balance of the period of public operation. Dividends upon the common shares shall be payable quarterly, but no dividends shall be paid upon such common shares in excess of the rates herein specified. The first payment shall be made at the expiration of six months from the commencement of public operation, and the total of the first three quarterly dividend payments shall be five per cent on the par value of the common stock.

SECTION 7. The trustees shall, within sixty days after their appointment and qualification, fix and put in operation rates of fare which in their judgment will produce sufficient income to meet the cost of the service as defined in section six, and within sixty days thereafter shall adopt and publish a schedule of eight different grades of fare, of which four shall be below and four above the rate of fare first established; and whenever by reason of any change in the existing rate of fare there are less than four grades, either above or below the rate then in force, the trustees shall forthwith adopt and publish a schedule of additional grades of fare so that there shall always be not less than four grades of fare above and below the existing rate of fare.

If at any time the trustees shall be of opinion that said rates of fare or schedule should be changed, either with regard to the method or basis upon which the fares and transfer privileges are established, or because the steps between the different grades are too small or too great, or for any other reason, the trustees may adopt, publish, and put in effect new schedules or rates of fare to take the place of the existing schedule or rates of fare.

SECTION 8. The reserve fund shall be used only for the purpose of making good any deficiency in income as provided in section nine or for reimbursing the commonwealth as provided in sections eleven and thirteen, and until such use, may

be invested in income-producing securities in the discretion of the trustees, and all income or interest received thereon shall be treated as part of the general income of the company.

SECTION 9. Whenever the income of the company is insufficient to meet the cost of the service as herein defined, the reserve fund shall be used as far as necessary to make up such deficiency, and whenever, on the other hand, such income is more than sufficient to meet the cost of the service, the excess shall be transferred to and become a part of the reserve fund.

SECTION 10. [As amended by Sp. Acts, 1919, c. 245.] The trustees shall, on certain dates not more than twelve months apart, as from time to time may be fixed by them, consider a change of the rates of fare in force. If, as of the days so fixed, the amount of the reserve fund shall exceed by thirty per cent or more the amount originally established, and during the preceding twelve months the income shall have exceeded the cost of the service, the trustees shall, within one month thereafter, put into effect the grade of fare that will, in their opinion, be sufficient to provide enough revenue to meet the requirements of section six; and if, as of any such day, the amount of the reserve fund shall be less than seventy per cent of the amount originally established, and during the preceding twelve months the income has been less than the cost of service, the trustees shall, within one month thereafter, put into effect the next higher grade of fare, and the fare shall continue to be decreased or increased, as the case may be, subject to the same conditions, as the amount of the reserve fund shall be above or below said limits, as of such dates. In determining the amount of the reserve fund for the purposes of this section only, there shall first be deducted therefrom any amounts which have been paid by the commonwealth to the company under the provisions of section eleven, and for which the commonwealth has not been reimbursed. Nothing herein contained shall impair the authority given by section seven.

[The amendment to section 10 was accepted by the Directors December 29, 1919.]

SECTION 11. [As amended by Sp. Acts of 1919, c. 244.] If, as of the last day of June in the year nineteen hundred and nineteen, or the last day of any June thereafter, the amount

remaining in the reserve fund shall be insufficient to meet the deficiency mentioned in section nine, it shall be the duty of the trustees to notify the treasurer and receiver general of the commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and the commonwealth shall thereupon pay over to the company the amount so ascertained. Pending such payment it shall be the duty of the trustees to borrow such amount of money as may be necessary to enable them to make all payments, including dividend payments, as they become due. If, as of the last day of any June thereafter during the period of public operation, the reserve fund shall exceed the amount originally established, the trustees shall apply the excess, so far as necessary, to reimbursing the commonwealth for any amounts which it may have paid to the company under the provisions hereof, and the commonwealth shall thereupon distribute the amount so received among the cities and towns in which the company operates, in proportion to the amounts which they have respectively been assessed as provided in section fourteen.

In order to meet any payment required of the commonwealth under the provisions of this section the treasurer and receiver general may borrow at any time, in anticipation of the assessments to be levied upon the cities and towns, such sums of money as may be necessary to make said payments, and he shall repay any sums so borrowed as soon after said assessments are paid as is expedient.

[The amendment to section 11 was accepted by the Directors December 29, 1919.]

SECTION 12. Notwithstanding anything contained in this act, the public management and operation of the railway system of the company shall continue after the expiration of said ten year period upon the terms and conditions herein specified until such time as the commonwealth shall elect to discontinue such public management and operation. The commonwealth shall have the right to terminate such public management and operation, either at the expiration of the said ten year period or at any time thereafter, by appropriate legislation passed not less than two years before the date fixed for such termination.

SECTION 13. It shall be the duty of the trustees to maintain the property of the company in good operating condition and to make such provision for depreciation, obsolescence and rehabilitation, that, upon the expiration of the period of public management and operation, the property shall be in good operating condition. If the period of public management and operation expires, control of the property shall then revert to the company, and if at that time the reserve fund shall be less than the amount originally established because the income during the period of public management and operation has been insufficient to pay the cost of the service, the commonwealth shall forthwith pay over to the company an amount sufficient to restore it to its original amount; and if the amount in said reserve fund is then in excess of the amount originally established and any amount required to meet the cost of the service to the expiration of such period, such excess shall be paid into the treasury of the commonwealth and distributed among the cities and towns in which the company operates in the same proportions as the assessments provided for by section fourteen.

SECTION 14. In case the commonwealth shall be called upon to pay to the trustees or the company any amount under the provisions of sections eleven and thirteen, such amount with interest or other charges incurred in borrowing money for the purpose shall be assessed upon the cities and towns in which the company operates by an addition to the state tax next thereafter assessed in proportion to the number of persons in said cities and towns using the service of the company at the time of said payment, said proportion to be determined and reported to the treasurer and receiver general by the trustees from computations made in their discretion for the purpose.

SECTION 15. Upon the termination of the period of public management and operation, the company shall manage and operate the property and may fix and collect such just and reasonable fares as will produce an income sufficient to pay the reasonable cost of the service as defined in section six, including dividends upon the common stock from time to time outstanding of six per cent per annum on the par value thereof but no more, and may establish schedules of fares which shall automatically increase or decrease in the same manner as is authorized in the case of the trustees: *provided*, that the com-

monwealth shall be under no liability to make any payments to the company by reason of any deficiencies in income accruing after the discontinuance of public operation. The company shall thereafter be subject to public regulation and supervision in such manner as may be determined by the general court, but such regulation and supervision shall not be exercised so as to reduce the income below the reasonable cost of the service as defined in this act.

. . . . . .

Chapter 244 of the Special Acts of 1919.

AN ACT TO PROVIDE FOR ANNUAL INSTEAD OF SEMI-ANNUAL PAYMENTS BY THE COMMONWEALTH OF DEFICITS IN THE COST OF OPERATION OF THE BOSTON ELEVATED RAILWAY COMPANY.

SECTION 1. Section eleven of chapter one hundred and fifty-nine of the Special Acts of nineteen hundred and eighteen is hereby amended by striking out in the second and third lines the words "December or," and in the fourteenth line the words "or December," so as to read as follows:

SECTION 11. If, as of the last day of June in the year nineteen hundred and nineteen, or the last day of any June thereafter, the amount remaining in the reserve fund shall be insufficient to meet the deficiency mentioned in section nine, it shall be the duty of the trustees to notify the treasurer and receiver general of the commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and the commonwealth shall thereupon pay over to the company the amount so ascertained. Pending such payment it shall be the duty of the trustees to borrow such amount of money as may be necessary to enable them to make all payments, including dividend payments, as they become due. If, as of the last day of any June thereafter during the period of public operation, the reserve fund shall exceed the amount originally established, the trustees shall apply the excess, so far as necessary, to reimbursing the commonwealth for any amounts which it may have paid to the company under the provisions hereof, and the commonwealth shall thereupon

distribute the amount so received among the cities and towns in which the company operates, in proportion to the amounts which they have respectively been assessed as provided in section fourteen.

In order to meet any payment required of the commonwealth under the provisions of this section the treasurer and receiver general may borrow at any time, in anticipation of the assessments to be levied upon the cities and towns, such sums of money as may be necessary to make said payments, and he shall repay any sums so borrowed as soon after said assessments are paid as is expedient.

Chapter 245 of the Special Acts of 1919.

AN ACT TO PROVIDE FOR ANNUAL INSTEAD OF QUARTERLY CHANGES IN RATES OF FARE BY THE BOSTON ELEVATED RAILWAY COMPANY.

SECTION 1. Chapter one hundred and fifty-nine of the Special Acts of nineteen hundred and eighteen is hereby amended by striking out section ten and substituting the following:—

Section 10. The trustees shall, on certain dates not more than twelve months apart, as from time to time may be fixed by them, consider a change of the rates of fare in force. If, as of the days so fixed, the amount of the reserve fund shall exceed by thirty per cent or more the amount originally established, and during the preceding twelve months the income shall have exceeded the cost of the service, the trustees shall, within one month thereafter, put into effect the grade of fare that will, in their opinion, be sufficient to provide enough revenue to meet the requirements of section six; and if, as of any such day, the amount of the reserve fund shall be less than seventy per cent of the amount originally established, and during the preceding twelve months the income has been less than the cost of service, the trustees shall, within one month thereafter, put into effect the next higher grade of fare, and the fare shall continue to be decreased or increased, as the case may be, subject to the same conditions, as the amount of the reserve fund shall be above or below said limits, as of such dates. In determining the amount

of the reserve fund for the purposes of this section only, there shall first be deducted therefrom any amounts which have been paid by the commonwealth to the company under the provisions of section eleven, and for which the commonwealth has not been reimbursed. Nothing herein contained shall impair the authority given by section seven.

Chapter 333 of the Acts of 1931.

AN ACT REVISING AND EXTENDING THE TERM OF THE LEASE TO THE COMMONWEALTH OF THE PROPERTIES OF THE BOSTON ELEVATED RAILWAY COMPANY AND CONTINUING PUBLIC MANAGEMENT AND OPERATION THEREOF.

SECTION 1. Public management and operation of the Boston Elevated Railway Company under the provisions of chapter one hundred and fifty-nine of the Special Acts of nineteen hundred and eighteen, as heretofore and hereby amended, shall continue until July first, nineteen hundred and fifty-nine, and thereafter, unless terminated on said date or thereafter, in the manner provided in section twelve of said chapter one hundred and fifty-nine.

SECTION 2. Dividends payable upon the common stock of the Boston Elevated Railway Company, hereinafter called the company, and included in the cost of the service under said chapter shall be reduced from six per cent to five per cent upon the par value thereof from the time this act takes effect so long as public management and operation continues.

SECTION 3. If at any time while public management and operation continues a deficit shall occur of which notice is given to the treasurer and receiver general of the commonwealth under section eleven of said chapter one hundred and fifty-nine, the trustees of the Boston Elevated Railway Company, hereinafter called the trustees of the company, shall at the same time give like notice to the trustees of the metropolitan transit district created by chapter three hundred and eighty-three of the acts of nineteen hundred and twenty-nine who shall forthwith call a meeting of the metropolitan transit council created by said chapter three hundred and eighty-three to consider whether or not the fares and charges for

service shall be increased. If said council so determines, the trustees of the company shall within sixty days after receipt of written notice of such determination put into effect such higher rates of fare and charges for all or any services furnished or operated as in their judgment will be sufficient, or best adapted, to prevent thereafter a further deficit to be assessed upon the cities and towns in which service is operated. The trustees of the company shall also notify the department of public utilities whenever such a deficit shall occur. Upon receipt of such notice said department shall carry on such investigation as it may deem advisable of the operations and the expenses of the company, and shall make a report to the governor and the members of the metropolitan transit council in writing of its findings, together with any recommendations, whereby future deficits may be avoided or reduced, and the service improved. Such reports whenever made shall be made public. From the time this act takes effect so long as public management and operation continues, the operation of section ten of said chapter one hundred and fifty-nine, as amended, shall be suspended.

. . . . . .

SECTION 4. At any time and from time to time after this act takes effect, the trustees of the company shall have authority, in the name and on behalf of the company, and without further authorization than herein contained, in addition to the bonds, coupon notes or other evidences of indebtedness payable at periods of more than one year after the date thereof which the company may otherwise lawfully issue, to issue bonds of the company to an amount not exceeding thirty million dollars. The proceeds of such bonds shall be used for the retirement of the existing preferred stocks of the company as provided in this act including the payment of all amounts found due under section fourteen and for damages paid or recovered under section twelve and not otherwise. Said bonds shall bear interest at the rate of six per cent per annum, and shall be for the term of forty years.

The payment of interest as it accrues on said bonds shall be deemed part of the cost of the service as defined in section six of said chapter one hundred and fifty-nine.

Said bonds, both as to principal and income, are hereby made exempt from all taxes levied under authority of the commonwealth and shall contain a recital to such effect.

Said bonds shall be subject to the priority of bonds, coupon notes or other evidences of indebtedness issued for the purposes and under the authority specified in section eighteen and shall be sold only to the metropolitan transit district, which shall retain the same in its treasury until surrendered for cancellation as provided in section seven.

SECTION 5. The trustees of the metropolitan transit district in the name and on behalf of said district shall from time to time upon and in accordance with the request of the trustees of the company purchase the bonds issued under authority of the preceding section at the face value thereof, and shall procure the funds necessary therefor by the issue of notes and bonds of the district under and in the manner provided in section ten of chapter three hundred and eighty-three of the acts of nineteen hundred and twenty-nine, and the provisions of said section shall apply thereto in the same manner and to the same extent as if such notes and bonds were specifically authorized in said chapter. Said bonds may be issued on either the sinking fund or serial payment plan, and if issued on the serial plan, the trustees of said district shall endeavor so to arrange the maturities thereof that the bonds maturing each year will be met by the amounts available from interest upon the bonds purchased and from the special compensation tax to be paid by the company as provided in the following section. All amounts received by the district from said interest and special compensation tax shall be applied in payment of interest and principal of the notes and bonds issued under this section as and when due and any balance shall be accumulated in a sinking fund to be used for such purpose. Said fund may be invested by the trustees of the district in any bonds or coupon notes of the company or in other securities which are legal investments for savings banks in this commonwealth and all income accruing therefrom shall be added to the fund.

SECTION 6. The company shall annually on the first day of February pay to the metropolitan transit district, for the

benefits conferred by this act, a special compensation tax of an amount which, when added to the interest payable to the said district, during the preceding calendar year upon the bonds of the company acquired under section five, shall be sufficient to pay all interest upon the notes and bonds of the district issued to provide funds for such acquisition and payable during said preceding calendar year increased by an amount which shall be computed at the rate of two per cent per annum on the amount of bonds of the company held by the district for the time while held during said year.

SECTION 7. Upon the retirement of all bonds and notes of the district issued under the provisions of section five including all notes or bonds issued to refund the same, or upon the accumulation of a sinking fund sufficient to pay the same with interest to maturity, the district shall surrender to the company for cancellation the bonds of the company purchased under said section and receive in exchange therefor a "certificate of indebtedness" of the company in the total amount of the par value of all bonds of the company surrendered to the company by the district under the provisions of this section. Said "certificate of indebtedness" shall not be entitled to receive interest and shall be payable only in liquidation or in the event of a sale of substantially all the assets and franchises of the company and, in liquidation, only after payment of all other indebtedness of the company.

. . . . . .

SECTION 17. The acceptance of this act by the company shall constitute an agreement upon its part that in no event after termination of public management and operation shall dividends in excess of six per cent per annum be declared or paid upon its common stock.

Such acceptance shall also constitute an agreement by the company to sell to the commonwealth or any political subdivision thereof or any corporation specifically authorized by the commonwealth to purchase the same, at any time during the period of public management and operation, its whole assets, property and franchises as a going concern upon the assumption by the commonwealth or such political subdivision of all its outstanding indebtedness and liabilities, and

the payment of an amount in cash equal to any amount paid in in cash for stock hereafter issued and also an amount in cash equal to one hundred and five dollars per share for all common stock at present issued and then still outstanding decreased by one half of any sums hereafter assessed under the provisions of said chapter one hundred and fifty-nine or of this act upon cities and towns served by the company which have not then been repaid to the commonwealth provided however that such decrease shall not reduce the amount payable on account of said common stock below the amount of eighty-five dollars per share. A sale by the company under the foregoing option shall work a dissolution of the company subject to the provisions of sections fifty-one and fifty-two of chapter one hundred and fifty-five of the General Laws.

Such acceptance shall also constitute an agreement by the company that none of the provisions of this act shall preclude the commonwealth or any political subdivision thereof from taking the property and franchises of the company at any time through the exercise of the power of eminent domain and that in the event of such a taking the compensation to be paid to the company shall not be enhanced or diminished by reason of the passage of this act or of any amendments thereof.

Such acceptance shall also constitute a contract between the company and the commonwealth, binding upon the company, by which it agrees that after termination of public management and operation, it shall be subject to and bound by such regulation and determination of service to be furnished or operated and such regulation and fixing of rates and charges for service as the general court or the department of public utilities or any other board or commission to which such powers may be delegated by the general court shall thereafter prescribe, provided that such powers shall not be exercised so as to reduce the income of the company below an amount necessary to enable it to earn and pay dividends of six per cent per annum upon the par value of its common stock in addition to the dividend requirements for any preferred or special stock hereafter issued in accordance with law.

. . . . . .

SECTION 19. None of the provisions of this act or of said chapter one hundred and fifty-nine shall be construed to constitute a contract binding upon the commonwealth other than (*a*) the provisions of section one of this act which define the term of public management and operation herein and therein provided for, (*b*) the provisions which define the terms and conditions under which during said term of public management and operation the property owned, leased or operated by the company shall be managed and operated by the trustees of the company, (*c*) the provisions of sections four and eighteen of this act providing priorities of certain bonds, coupon notes or other evidences of indebtedness of the company and (*d*) the provisions of section thirteen of said chapter one hundred and fifty-nine, which provisions shall constitute a contract binding upon the commonwealth.

SECTION 20. This act shall be regarded as amendatory of said chapter one hundred and fifty-nine of the Special Acts of nineteen hundred and eighteen, and this act and said chapter shall, for purposes of interpretation and construction, be treated as one act.

. . . . . .

SECTION 22. Until the period of ninety days within which this act must be accepted as provided in section eight has expired, the operation of sections ten and eleven of said chapter one hundred and fifty-nine which authorize an increase in fares and payment of deficits by the commonwealth shall be suspended and no such payment shall be required in the current year. This section shall take effect upon its acceptance by vote of the board of directors of the company.

SECTION 23. When all the second preferred stock of the company has been retired, the special trust fund established under the provisions of section nine of chapter seven hundred and forty of the acts of nineteen hundred and eleven shall, to the extent necessary therefor, be converted by the trustees of the company into cash and the same shall thereupon be applied to repay to the commonwealth all amounts which, prior to the effective date of this act, have been assessed under the provisions of chapter one hundred and fifty-nine of the Special Acts of nineteen hundred and eighteen upon the cities and

towns served by the company and which have not been previously repaid to the commonwealth, and the treasurer and receiver general of the commonwealth shall thereupon distribute the same to such cities and towns as provided in said chapter. Any balance remaining in said fund shall be applied as provided in said chapter seven hundred and forty.

SECTION 24. Section eight of this act shall take effect upon its passage, and section twenty-two thereof shall take effect upon acceptance as provided therein. The remaining provisions of this act shall not take effect unless said section twenty-two is accepted as therein provided before June thirtieth, nineteen hundred and thirty-one nor unless this act is accepted and certificate filed as provided in section eight, but shall take effect upon such filing provided that said section twenty-two is accepted as aforesaid before said June thirtieth and provided that section three A shall not take effect as to the city of Boston unless accepted as therein provided.

Chapter 99 of the Acts of 1935.

AN ACT RELATIVE TO THE DATES AS OF WHICH AMOUNTS TO BE PAID OR REPAID ON ACCOUNT OF DEFICITS IN THE COSTS OF OPERATION OF THE BOSTON ELEVATED RAILWAY COMPANY SHALL BE DETERMINED.

SECTION 1. Section eleven of chapter one hundred and fifty-nine of the Special Acts of nineteen hundred and eighteen, as amended by chapter two hundred and forty-four of the Special Acts of nineteen hundred and nineteen, is hereby further amended by inserting after the word "thereafter" in the second and third and in the thirteenth lines the words: — to and including the last day of June in the year nineteen hundred and thirty-four, or as of the last day of March in any year after the year nineteen hundred and thirty-four, — so as to read as follows: — *Section 11.* If, as of the last day of June in the year nineteen hundred and nineteen, or the last day of any June thereafter to and including the last day of June in the year nineteen hundred and thirty-four, or as of the last day of March in any year after the year

nineteen hundred and thirty-four, the amount remaining in the reserve fund shall be insufficient to meet the deficiency mentioned in section nine, it shall be the duty of the trustees to notify the treasurer and receiver general of the commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and the commonwealth shall thereupon pay over to the company the amount so ascertained. Pending such payment it shall be the duty of the trustees to borrow such amount of money as may be necessary to enable them to make all payments, including dividend payments, as they become due. If, as of the last day of any June thereafter to and including the last day of June in the year nineteen hundred and thirty-four, or as of the last day of March in any year after the year nineteen hundred and thirty-four, during the period of public operation, the reserve fund shall exceed the amount originally established, the trustees shall apply the excess, so far as necessary, to reimbursing the commonwealth for any amounts which it may have paid to the company under the provisions hereof, and the commonwealth shall thereupon distribute the amount so received among the cities and towns in which the company operates, in proportion to the amounts which they have respectfully been assessed as provided in section fourteen.

In order to meet any payment required of the commonwealth under the provisions of this section the treasurer and receiver general may borrow at any time, in anticipation of the assessments to be levied upon the cities and towns, such sums of money as may be necessary to make said payments, and he shall repay any sums so borrowed as soon after said assessments are paid as is expedient.

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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 609

BOSTON ELEVATED RAILWAY COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 97–118) is reported at 45 B. T. A. 906. The opinion of the circuit court of appeals (R. 127–133) is reported at 131 F. (2d) 161.

JURISDICTION

The judgment of the circuit court of appeals was entered November 4, 1942 (R. 134). The petition for a writ of certiorari was filed December 31, 1942. The jurisdiction of this Court is

invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The Commonwealth of Massachusetts provided by statute (known as the Public Control Act) for the operation of the Boston Elevated Railway Company by public trustees. The Act guaranteed that, if the Company's earnings should be insufficient to pay its operating costs *plus dividends* at a fixed rate, the Commonwealth would annually pay the difference. In the event that the earnings should exceed the operating costs plus such dividends, the excess was to be placed in a "reserve fund." Ultimately, it was to be paid over to the Commonwealth and in the meanwhile it could be drawn upon to satisfy the Commonwealth's guarantee.

The Company has been operating at a deficit since 1931 and during the years 1933–1937, here involved, the Commonwealth paid an average of about $2,000,000 a year in accord with its guarantee. The question is whether those payments constituted taxable income to the Company.

STATUTES INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in

> whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits, and income derived from any source whatever * * *.

The relevant provisions of Massachusetts Special Acts, 1918, c. 159, as amended (known as the Public Control Act) are either quoted or summarized in the Statement, pp. 4–6, *infra*, and are printed in full at pp. 10–28 of the petition.

STATEMENT

The petitioner, the Boston Elevated Railway Company, is a corporation engaged in the transportation of passengers by elevated, subway and surface railway, and by bus lines, in the City of Boston and suburban cities and towns. During the tax years here involved, the properties were operated under public management by a board of trustees appointed by the Governor of the Commonwealth of Massachusetts in accordance with the Public Control Act of May 22, 1918, as amended.[1] (R. 101.) The trustees act-

[1] This Act was considered by the Court in connection with other questions in *Boston* v. *Jackson*, 260 U. S. 309, and *Helvering* v. *Powers*, 293 U. S. 214.

ing as agents of the company and not of the Commonwealth, exercised "all the rights and powers of said company and its directors", including the payment of dividends (Sections 2, 3).

The basic scheme of the Public Control Act is that the company in exchange for its surrender of management and control shall annually receive, after all expenses, a sum adequate to pay dividends on the preferred stock at the specified rates and on the common stock at the rate of five per centum and no more (Section 6, as amended by chapter 333, Section 2, of Acts of 1931). The mechanics for achieving that result are as follows: Section 6 requires the trustees to fix such rates of fare as will reasonably produce sufficient income to meet the "cost of the service", which is expressly defined to include operating expenses, fixed charges, taxes, and the stipulated dividends upon the capital stock. Section 6 also specifically prohibits the payment of dividends in any greater amount. Sections 5 and 9 require that a reserve fund be set aside. It is to be drawn upon when the earnings do not equal the "cost of the service" and into it are paid any annual earnings in excess of the "cost of the service". Section 11 as amended by Special Acts of 1919, c. 244, makes provision for securing to the company the "cost of the service", including dividends, in the event that the reserve fund should be exhausted. To that end it provides:

> If, as of the last day of June in the year nineteen hundred and nineteen, or the last day of any June thereafter,[2] the amount remaining in the reserve fund shall be insufficient to meet the deficiency mentioned in section nine, it shall be the duty of the trustees to notify the treasurer and receiver general of the commonwealth of the amount of such deficiency, less the amount, if any, in the reserve fund applicable thereto, and the commonwealth shall thereupon pay over to the company the amount so ascertained. Pending such payment it shall be the duty of the trustees to borrow such amount of money as may be necessary to enable them to make all payments, including dividend payments, as they become due. If, as of the last day of any June thereafter during the period of public operation, the reserve fund shall exceed the amount originally established, the trustees shall apply the excess, so far as necessary, to reimbursing the commonwealth for any amounts which it may have paid to the company under the provisions hereof * * *.

Section 13 provides that at the end of the term of public management and control, any deficiency in the original amount of the reserve fund shall be made up by the Commonwealth and that any excess over the original amount shall be paid to

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[2] By chapter 99 of Acts of 1935 this date was changed to March for the years subsequent to 1934.

the Commonwealth. Thus, the arrangement secured the company a fixed annual return over expenses and provided that any earnings in excess of that amount should go to the Commonwealth, first, as a reserve to meet the Commonwealth's obligation and, ultimately, as actual payments into its Treasury.

In 1931 the reserve fund was exhausted. In each of the years 1933 to 1937 the earnings were below the stipulated amount, and accordingly the Commonwealth paid to the company sums averaging nearly $2,000,000 each year (R. 107–108). These moneys were credited annually to the company's profit and loss account and were used, after payment of expenses not covered by earnings, to pay annual dividends of $1,193,970 (R. 109).

The company did not include the payments by the Commonwealth in gross income in making up its income tax returns (R. 64). The Commissioner ruled that the payments should have been so included and determined a deficiency. The Board of Tax Appeals sustained the Commissioner's determination upon this point (R. 118)[3] and its decision in turn was affirmed by the circuit court of appeals (R. 134).

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[3] The Board held that certain details of the Commissioner's computations were erroneous and required recomputations (R. 117, 118).

ARGUMENT

In *Texas & Pacific Ry. Co.* v. *United States*, 286 U. S. 285, the Court held to be taxable income payments made to a carrier by the United States under an agreement guaranteeing the carrier a specified operating income for six months in exchange for its promise to pay to the United States any earnings in excess of the agreed amount. The instant case is identical, except that the arrangement extends over a series of annual accounting periods instead of a single six months period. The only contention open to petitioner, therefore, is that the deficiency payments made by the Commonwealth were loans and not income because there might possibly be excess earnings in a subsequent annual accounting period which would go to reimburse the Commonwealth. But the nature of the deficiency payments depends upon the interpretation to be given the Public Control Act and not upon any disputed questions of federal law. The court below was undoubtedly familiar with the local background of the Act and the correctness of its interpretation is not a matter of such general importance as to require decision by this Court.

Moreover, the ruling of the circuit court of appeals is plainly correct. "The Act, accepted by the Company, constitutes in substance an agreement between the Company and the Com-

monwealth that the latter shall temporarily take over the management and operation and pay specified amounts by way of compensation" (*Helvering* v. *Powers*, 293 U. S. 214, 223). The essence of the arrangement was that the company should receive the guaranteed annual compensation from earnings so far as possible and the balance in payments from the Commonwealth if necessary, while on the other hand the Commonwealth should receive the earnings of any year in excess of the guaranteed compensation.

In so analyzing the Public Control Act, we do not overlook the provisions establishing and governing the reserve fund. The Commonwealth meets its obligations under the Act by assessing the cities and towns served by the property for any deficiencies paid by it, and it is required to distribute to them any earnings in excess of the guaranteed compensation (Sections 11, 13, 14). The underlying theory is that the people benefited by the properties should pay the exact cost of service; their contribution in the form of fares is therefore increased in the amount of assessments for payments necessary to make up deficiencies in earnings or decreased by the redistribution of excess earnings. The provisions establishing and governing the reserve fund were intended to avoid, so far as possible, the necessity of making these assessments and distributions an-

nually to meet fluctuations in earnings. To this end the Act provides that the deficiency payments shall be made from the reserve fund whenever possible and that the annual excess earnings should be put into and retained in the reserve fund until the termination of public control, unless the reserve fund should be above its original level and the Commonwealth should require reimbursement for prior deficiency payments. But this is the only purpose of the reserve fund provisions. So far as concerns the relationship between the Commonwealth and the company, it was intended to make the settlement on an annual basis so that the company would annually receive the fixed compensation and no more.

There is no such relationship between the deficiency payments by the Commonwealth and the payments of excess earnings by the company as would warrant treating the former as loans or advances to be repaid from excess earnings. The obligation of the Commonwealth is not conditioned upon the existence of excess earnings from the past or upon the possibility of excess earnings in the future. The company made no promise of repayment, absolute or conditional. Furthermore, the company's obligation is to turn over all earnings in any year in excess of the guaranteed annual income, whether or not deficiency payments have been made by

the Commonwealth which it has not recouped. Over a period of years the payments made by the Commonwealth might be offset by the earnings in excess of the guaranteed minimum but that outcome would be the result of chance; the Public Control Act does not relate the two, and neither the company's nor the Commonwealth's payments are in any sense a return of payments made by the other.

The company's treatment of the payments by the Commonwealth also shows that they were not loans. They were entered in the profit and loss account and were distributed as ordinary dividends. The dividends were, of course, income to the stockholders, but under Section 25 of the Revenue Acts of 1932 and 1934 they were exempted from the normal tax on the theory that they were distributions of corporate earnings or profits. The court below correctly held, therefore, that the annual payments to the company were not loans but were income subject to its unrestricted control, and were subject to be taxed in the year in which they are accrued.[4] *Texas & Pacific Ry. Co.* v. *United States,* 286 U. S. 285; *Helvering* v. *Clai-*

[4] The company keeps its books on the accrual basis of accounting (R. 63).

borne-Annapolis Ferry Co., 93 F. (2d) 875 (C. C. A. 4), and *Lykes Bros. S. S. Co.* v. *Commissioner*, 126 F. (2d) 725 (C. C. A. 5). The possibility that the company may at some future date be called upon to make payments to the Commonwealth—a possibility which is now exceedingly remote—does not exempt from the tax the income which it has received. *North American Oil Consolidated* v. *Burnet*, 286 U. S. 417; *National City Bank of New York v. Helvering*, 98 F. (2d) 93 (C. C. A. 2); *Barker* v. *Magruder*, 95 F. (2d) 122 (App. D. C.)

Petitioner contends that the decision below conflicts with two decisions of the Circuit Court of Appeals for the Fifth Circuit but examination of those cases shows that they are not in point. In *McKnight* v. *Commissioner*, 127 F. (2d) 572, the court held only that the principal amounts embezzled by a taxpayer were not income to him at the time of the embezzlement. In *Clinton Hotel Realty Corp.* v. *Commissioner*, 128 F. (2d) 968, a deposit made under a contract of lease was held not to be income when made because it was to be held by the lessor as security for the performance of the covenants of the lessee and was not subject to the unrestricted control of the lessor. Factually, those situations are too remote to be persuasive here.

CONCLUSION

There is no conflict of decisions or question of general importance. The decision of the circuit court of appeals is correct. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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JANUARY, 1943.

U. S. GOVERNMENT PRINTING OFFICE: 1943